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## **Re: Planning 2012: Travel and Entertainment Review**

Although the computer age and modern telecommunications have reduced the need for in-person contact, it is still sometimes necessary for businesses to send employees out of town on business, or to entertain clients and customers. How travel and entertainment expenses are handled can have an impact on your net income, your paperwork burden, and on the tax results for you and your employees.

If you require employees to substantiate travel or entertainment expenses that are bona-fide business deductions, partial or complete advances or reimbursements are not treated as compensation income to the employee, and the advance or reimbursement is not subject to social security taxes or to income tax withholding. However, only 50 percent of any business-related meal or entertainment expense is deductible by the company, including costs of meals consumed by employees while they are traveling.

To ensure that the reimbursement is not subject to payroll and withholding taxes, the business must maintain a fairly detailed recordkeeping system. For travel, employees must submit a written statement of the time, place, destination and business purpose of the trip and the amount of expenses incurred by category (e.g., travel, meals, lodging). For meals or entertainment, the employee must submit a written statement showing time, place and cost of the event, who was entertained, and the business purpose of the meal or entertainment (if the event follows or precedes a business discussion, additional recordkeeping is required). Finally, the employee must keep and turn in to the employer documentary evidence such as receipts for all lodging expenses, and for other travel and entertainment expenses over \$75.

Because the recordkeeping can be onerous, the law provides some shortcuts, depending on the type and frequency of the travel and entertainment expenses. For example, the paperwork burden and the cost of travel expenses can be decreased by giving employees who travel for business purposes a flat daily allowance, a per diem, which varies by destination, to cover meals, lodging and incidental expenses. If the daily allowances do not exceed IRS-determined maximums, they are payroll and income tax free with a minimum of paperwork; all that is required is a record of the time, place and business purpose of the travel. To-the-penny accounting of expenses and corroborating receipts is not necessary.

One simple way to cut out paperwork while boosting company tax deductions is to give employees a flat allowance for anticipated travel and entertainment, and not require these expenses to be substantiated. The allowance is fully deductible as compensation (assuming the employees' compensation packages are reasonable), and there is minimal paperwork required. The allowance, however, is subject to payroll and income tax withholding, and the company may not be able to determine what their actual travel and entertainment expenses are for budgeting purposes. In addition, there are unfavorable tax consequences for the employee, even if the travel and entertainment expenses are deducted on their own returns.

Travel and entertainment expenses are particularly susceptible to challenge by the IRS. However, in some instances, businesses may fail to deduct qualifying travel and entertainment expenses, or may be deducting these expenses improperly. We can perform a confidential review of your company's travel and entertainment expenses to ensure compliance with the complex rules that govern these deductions. Please call us to arrange an appointment at your earliest convenience.